



AT A GLANCE:

General Fund revenues ahead of last year by 4.4 percent, but fall short of budget. Sales tax revenue performance continues negative trend for most of the second half of 2007 (see page 5)

Development revenue down overall (see page 3)

Will the Puget Sound region dodge the recession bullet? (see page 7)

Kirkland home sales fall 27.7 percent; however prices rise 5.7 percent (see page 8)

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AS OF DECEMBER 31, 2007

Summary of All Operating Funds: *Revenue*

- General Fund** revenue was budgeted to increase in 2007 over 2006, largely from expectations of higher sales and utility tax revenue and property tax dedicated to public safety staffing. Actual revenues are slightly below budget by 0.6 percent due to a dip in development-related permit and fee revenues and weakening sales tax revenue. A more detailed analysis of sales tax revenue performance can be found beginning on page 5.
- Other General Government Funds** revenues were budgeted to increase in 2007 over 2006 primarily due to increased internal charges and the move of Multi-media Services from the General Fund to the Information Technology Fund. Actual collections are tracking slightly over budget at 1.9 percent largely due to the receipt of 2006 cable tax revenue in 2007 and higher than expected lodging tax receipts.
- Water Sewer Operating Fund** revenue was budgeted higher in 2007 than 2006 due to water and sewer rate increases and normal growth. Actual revenue is tracking higher than expected, at 4.5 percent over budget, due to strong water sales and despite lower than expected connection charges.
- Surface Water Management Fund** revenue collection was budgeted higher in 2007 than 2006 due to rate increases and normal growth. Actual revenue is slightly lower than budget at 0.7 percent. Surface Water fees are paid through property tax collection, which are primarily received in April and October.
- Solid Waste Fund** revenue collection was budgeted to increase in 2007 over 2006 due to higher rates and normal growth. Actual revenue is 0.4 percent under budget.

Resources by Fund	Year-to-Date Actual			Budget			Actual Percent of Budget	
	12/31/2006	12/31/2007	Percent Change	2006	2007	Percent Change	2006	2007
General Gov't Operating:								
General Fund	51,791,872	54,078,238	4.4%	49,091,816	54,384,669	10.8%	105.5%	99.4%
Other General Gov't Operating Funds	15,773,347	17,034,604	8.0%	15,170,554	16,721,577	10.2%	104.0%	101.9%
Total General Gov't Operating	67,565,219	71,112,842	5.3%	64,262,370	71,106,246	10.6%	105.1%	100.0%
Utilities:								
Water/Sewer Operating Fund	15,534,787	17,229,776	10.9%	15,802,180	16,494,804	4.4%	98.3%	104.5%
Surface Water Management Fund	5,119,064	5,142,167	0.5%	4,977,108	5,233,189	5.1%	102.9%	98.3%
Solid Waste Fund	7,467,634	7,875,356	5.5%	7,449,930	7,909,347	6.2%	100.2%	99.6%
Total Utilities	28,121,485	30,247,299	7.6%	28,229,218	29,637,340	5.0%	99.6%	102.1%
Total All Operating Funds	95,686,704	101,360,141	5.9%	92,491,588	100,743,586	8.9%	103.5%	100.6%

* Budgeted and actual revenues exclude resources forward and include interfund transfers.



Wireless Internet access at Marina Park

Kirkland's Information Technology Department provides technology support to City departments and maintains the City's internal technology infrastructure. It also pioneers revolutionary services to citizens and visitors, such as free wireless Internet access in the downtown area (as pictured above). Additionally, this department supports two public access television channels (including the production of original programming). KGOV, channel 21, is the legislative channel broadcasting programs such as City Council meetings and legislative updates from Olympia. Channel 75, K-Life, has a community focus. In addition to monthly news magazines, K-Life airs videos generated by the Youth and Senior Councils. Other programs include public safety, fire safety, art and a series titled *Wild about Washington*.

Summary of All Operating Funds: *Expenditures*

- General Fund** expenditures were budgeted to increase in 2007 over 2006 largely due to increased personnel costs and additional staffing, as well as budgets for unfinished projects "carried over" from the prior year. Actual expenditures are 6.1 percent under budget due to uncompleted projects, lower personnel costs from position vacancies and delayed hiring of new positions, and 2007 budgeted payments that will occur in 2008. Expenditures were under budget despite higher than expected firefighter overtime and jail costs.
- Other Operating Funds** expenditures were budgeted to increase in 2007 over 2006 primarily due to increased personnel, operating and fuel costs, and the shift of Multi-media Services from the General Fund. Actual expenditures are 11.6 percent under budget due to timing of vehicle and computer purchases, and lower than expected fuel and repairs and maintenance costs.
- Water/Sewer Operating Fund** expenditures were budgeted to increase in 2007 over 2006 due to higher water purchases and sewer treatment costs and increased regional connection charges paid to Cascade Water Alliance (covered by regional connection charge revenue). Actual expenditures are 3 percent under budget primarily due to position vacancies.
- Surface Water Management Fund** expenditures were budgeted to increase in 2007 over 2006 primarily due to increased funding for capital projects and additional plans generated from the completed Surface Water Master Plan, and higher personnel costs. Actual expenditures are 4.7 percent under budget due to uncompleted projects and despite unplanned additional West Nile virus eradication costs and new Washington State Department of Ecology permit fees.
- Solid Waste Fund** expenditures were budgeted to increase in 2007 over 2006 due to higher solid waste contract rates. Actual 2007 expenditures are 2 percent under budget due to normal variability in disposal contract billing payment amounts and position vacancies.

Expenditures by Fund	Year-to-Date Actual			Budget			Actual Percent of Budget	
	12/31/2006	12/31/2007	% Change	2006	2007	% Change	2006	2007
General Gov't Operating:								
General Fund	47,845,789	51,312,386	7.2%	49,962,235	54,627,886	9.3%	95.8%	93.9%
Other General Gov't Operating Funds	16,439,337	15,341,827	-6.7%	15,072,831	17,364,419	15.2%	109.1%	88.4%
Total General Gov't Operating	64,285,126	66,654,213	3.7%	65,035,066	71,992,305	10.7%	98.8%	92.6%
Utilities:								
Water/Sewer Operating Fund	15,485,432	16,411,972	6.0%	15,492,943	16,919,851	9.2%	100.0%	97.0%
Surface Water Management Fund	4,607,714	5,382,452	16.8%	4,939,600	5,646,029	14.3%	93.3%	95.3%
Solid Waste Fund	7,350,421	7,700,848	4.8%	7,247,024	7,860,184	8.5%	101.4%	98.0%
Total Utilities	27,443,567	29,495,272	7.5%	27,679,567	30,426,064	9.9%	99.1%	96.9%
Total All Operating Funds	91,728,693	96,149,485	4.8%	92,714,633	102,418,369	10.5%	98.9%	93.9%

* Budgeted and actual expenditures exclude working capital, operating reserves, capital reserves, and include interfund transfers.

Many significant General Fund revenue sources are economically sensitive, such as sales tax and development –related fees.

General Fund Revenue

General Fund revenue budgets were adjusted as part of the mid-biennial budget adjustment process to reflect revenue estimates. The following compares the adjusted budget to actual performance.

- **Sales tax** was budgeted to increase in 2007 over 2006 because of strong development-related activity. Actual revenue is 1 percent behind budget due to weakening of this activity as the year progressed. A detailed analysis of **sales tax** revenue can be found starting on page 5.
- **Utility tax** revenue was budgeted to increase from 2006 primarily due to higher utility rates. Actual revenue collection is 1.3 percent under budget due to slightly weaker growth than expected despite stronger than expected telecommunications taxes.
- **Business licenses and franchise fees** were budgeted to increase over 2006 primarily due to expected strong franchise fee performance. Actual revenue lagged behind budget for much of 2007, but ended 3.4 percent ahead of budget because of franchise and business license fees. The **revenue**
- **generating regulatory license** fee is 4.8 percent over budget. Timing of renewals from larger businesses at the end of the year was the primary factor for this trend.
- **Development-related** revenue budget was adjusted to decline in 2007 from 2006. **Building/structural permits** revenue ended even weaker than expected, 7.5 percent behind budget. **Engineering development charges** actual revenue is only 0.5 percent behind budget and **plan check/development** fees are 3.4 percent under budget. The trends for development-related revenue in 2007 reflect the volatility that is inherent in development activity and also are reflected in sales tax revenue performance (see page 5).
- **Miscellaneous revenues** were budgeted less in 2007 than 2006 primarily due to interest income revenue. Actual revenue is 31.9 percent ahead of budget due to NORCOM cost reimbursement from other agencies, higher than expected facilities leases and reimbursement for expenses generated from the *Extreme Makeover–Home Edition* television show.

General Fund 2007 revenues are almost \$1.9 million ahead of 2006 largely due to property, sales and utility taxes.

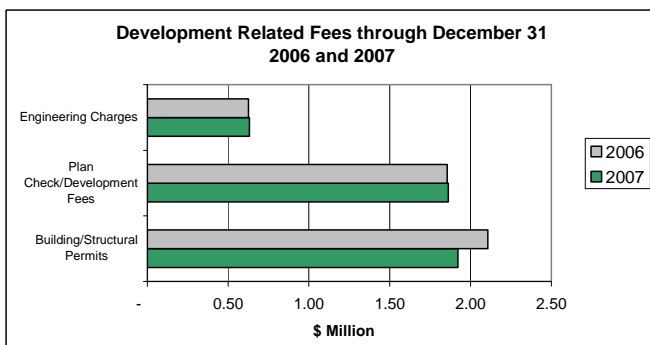
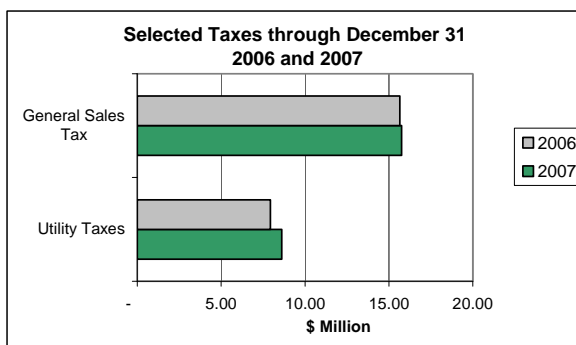
General Fund 2007 revenue is up 3.6 percent over 2006.

The General Fund is the largest of the General Government Operating funds. It is primarily tax supported and accounts for basic services such as public safety, parks and recreation, and community development.

About 372 of the City's 467 permanent employees are budgeted within this fund.

General Fund Resource Category	Year-to-Date Actual			Budget			Actual Percent of Budget	
	12/31/2006	12/31/2007	% Change	2006	2007	% Change	2006	2007
Taxes:								
Retail Sales Tax: General	15,658,027	15,756,446	0.6%	14,132,692	15,918,981	12.6%	110.8%	99.0%
Retail Sales Tax: Criminal Justice	1,036,737	1,159,184	11.8%	890,000	1,114,253	25.2%	116.5%	104.0%
Property Tax	8,127,663	8,612,296	6.0%	8,117,113	8,790,086	8.3%	100.1%	98.0%
Utility Taxes	7,932,114	8,611,700	8.6%	7,171,200	8,723,683	21.6%	110.6%	98.7%
Rev Generating Regulatory License	978,003	981,237	0.3%	900,000	936,671	4.1%	108.7%	104.8%
Other Taxes	432,061	534,792	23.8%	464,800	462,597	-0.5%	93.0%	115.6%
Total Taxes	34,164,605	35,655,655	4.4%	31,675,805	35,946,271	13.5%	107.9%	99.2%
Licenses & Permits:								
Building, Structural & Equipment Perm	2,107,060	1,921,523	-8.8%	2,084,742	2,078,436	-0.3%	101.1%	92.5%
Business Licenses/Franchise Fees	1,375,333	1,470,393	6.9%	1,184,775	1,421,435	20.0%	116.1%	103.4%
Other Licenses & Permits	226,338	238,051	5.2%	169,020	188,749	11.7%	133.9%	126.1%
Total Licenses & Permits	3,708,731	3,629,967	-2.1%	3,438,537	3,688,620	7.3%	107.9%	98.4%
Intergovernmental:								
Grants	126,048	195,460	55.1%	207,017	182,160	-12.0%	60.9%	107.3%
State Shared Revenues & Entitlements	543,723	636,521	17.1%	590,033	623,230	5.6%	92.2%	102.1%
Fire District #41	3,069,978	3,184,310	N/A	3,141,052	3,184,310	N/A	97.7%	100.0%
EMS	495,286	512,252	N/A	489,685	504,376	N/A	101.1%	101.6%
Other Intergovernmental Services	652,732	582,337	-10.8%	438,539	589,478	34.4%	148.8%	98.8%
Total Intergovernmental	4,887,767	5,110,880	4.6%	4,866,326	5,083,554	4.5%	100.4%	100.5%
Charges for Services:								
Internal Charges	3,291,789	3,377,529	2.6%	3,531,586	3,443,777	-2.5%	93.2%	98.1%
Engineering Services	625,331	631,926	1.1%	400,000	635,000	58.8%	156.3%	99.5%
Plan Check & Planning Fees	1,855,807	1,862,652	0.4%	2,276,836	1,927,660	-15.3%	81.5%	96.6%
Recreation	77,976	79,939	2.5%	74,000	79,516	7.5%	105.4%	100.5%
Other Charges for Services	687,970	888,969	29.2%	674,199	880,191	30.6%	102.0%	101.0%
Total Charges for Services	6,538,873	6,841,015	4.6%	6,956,621	6,966,144	0.1%	94.0%	98.2%
Fines & Forfeits	1,133,701	1,360,604	20.0%	1,157,550	1,317,860	13.8%	97.9%	103.2%
Miscellaneous	891,509	592,034	-33.6%	590,991	448,786	-24.1%	150.8%	131.9%
Total Revenues	51,325,186	53,190,155	3.6%	48,685,830	53,451,235	9.8%	105.4%	99.5%
Other Financing Sources:								
Interfund Transfers	466,686	888,083	N/A	405,986	933,434	N/A	115.0%	95.1%
Total Other Financing Sources	466,686	888,083	N/A	405,986	933,434	N/A	115.0%	95.1%
Total Resources	51,791,872	54,078,238	4.4%	49,091,816	54,384,669	10.8%	105.5%	99.4%

* Budgeted and actual revenues exclude resources forward.

General Fund Revenue *continued***General Fund Expenditures**

General Fund Department Expenditures	Year-to-Date Actual			Budget			Actual Percent of Budget	
	12/31/2006	12/31/2007	% Change	2006	2007	% Change	2006	2007
Non-Departmental	751,149	984,977	31.1%	851,614	1,128,527	32.5%	88.2%	87.3%
City Council	294,713	285,801	-3.0%	311,733	316,392	1.5%	94.5%	90.3%
City Manager's Office	2,520,099	3,081,824	22.3%	2,431,813	3,397,878	39.7%	103.6%	90.7%
Human Resources	889,200	966,042	8.6%	855,969	1,036,649	21.1%	103.9%	93.2%
City Attorney's Office	833,363	868,029	4.2%	881,406	997,460	13.2%	94.5%	87.0%
Parks & Community Services	5,001,458	5,463,872	9.2%	5,096,976	5,888,034	15.5%	98.1%	92.8%
Public Works (Engineering)	2,812,807	3,436,371	22.2%	2,887,897	3,784,150	31.0%	97.4%	90.8%
Finance and Administration	2,814,871	3,145,907	11.8%	2,891,824	3,417,487	18.2%	97.3%	92.1%
Planning & Community Development	2,886,620	3,161,601	9.5%	2,965,328	4,052,113	36.6%	97.3%	78.0%
Police	12,124,519	13,299,212	9.7%	12,669,585	14,096,033	11.3%	95.7%	94.3%
Fire & Building	14,692,710	15,888,517	8.1%	14,578,689	15,807,803	8.4%	100.8%	100.5%
Total Expenditures	45,621,509	50,582,153	10.9%	46,422,834	53,922,526	16.2%	98.3%	93.8%
Other Financing Uses:								
Interfund Transfers	2,224,280	730,233	-67.2%	3,539,401	705,360	-80.1%	62.8%	103.5%
Total Other Financing Uses	2,224,280	730,233	-67.2%	3,539,401	705,360	-80.1%	62.8%	103.5%
Total Expenditures & Other Uses	47,845,789	51,312,386	7.2%	49,962,235	54,627,886	9.3%	95.8%	93.9%

* Budgeted and actual expenditures exclude working capital, operating reserves, and capital reserves.

- The **Non-departmental** division 2007 expenditures were budgeted higher than 2006 due to a relocation of the Multi-media Services functions to Information Technology resulting in a change in accounting for the internal charges. Actual expenditures are 12.7 percent under budget primarily due to the timing of outside agency payments and lower than expected retiree medical costs.

2007 expenditure budgets were higher than 2006 for the following departments primarily due to higher personnel costs, including an unsettled labor contract from 2006 that settled in 2007 and additional positions added in 2007. In addition to this general trend, specific highlights and budget to actual comparisons by selected departments are listed below:

- Additions to the **City Manager's** 2007 budget include a communications program manager, municipal court staffing, and additional funding for economic development, outside agencies and one-time annexation studies. Actual expenditures are 9.3 percent under budget primarily due to the normal delay in hiring newly approved positions and uncompleted projects such as consulting services for NORCOM and annexation analysis.
- Additions to the **Human Resources Department** 2007 budget include an additional temporary human resources analyst. Actual expenditures are 6.8 percent under budget due to the delay of hiring the new position, timing of public safety assessment centers, and unfinished projects such as health care plans consulting services.

Compared to budget, 2007 General Fund actual expenditures are tracking slightly below last year (93.9 percent of budget in 2007 compared to 95.8 percent of budget in 2006) largely due to the normal delayed hiring of newly approved 2007 positions, position vacancies, and timing of major projects.

(Continued on page 5)

- Additions to the **Public Works Department** 2007 budget include additional positions, service packages for traffic counts and transportation management plans, as well as one-time annexation studies. Actual expenditures are 9.2 percent under budget due to position vacancies, the delay of hiring new positions, and unfinished projects such as the annexation analysis and transportation management plans.
- Additions to the **Parks & Community Services Department** 2007 budget include additional staffing, one-time increase in human services funding, and increases to parks maintenance expenditures. Actual expenditure are 7.2 percent under budget due to the normal delay in hiring new positions and timing of human services agency contract payments.
- Additions to the **Finance & Administration Department** 2007 budget include additional utility billing staff and one-time annexation studies. Actual expenditures are 7.9 percent under budget, due to projects that are in progress such as the annexation fiscal analysis.
- Additions to the **Planning Department** 2007 budget include additional development-related staffing and one-time annexation studies. Actual expenditures are 22 percent under budget due to the delay in hiring additional staffing and uncompleted projects such as the Park Place redevelopment environmental impact analysis, annexation analysis, and timing of payments to ARCH (A Regional Coalition for Housing).
- Additions to the **Police Department** 2007 budget include additional corrections officers and annexation planning staffing. Actual expenditures are 5.7 percent under budget largely due to position vacancies and despite higher than expected jail costs.
- Additions to the **Fire & Building Department** 2007 budget include additional development staff and a temporary emergency preparedness coordinator. Actual expenditures are 0.5 percent over budget primarily due to higher than expected fire operations overtime costs.

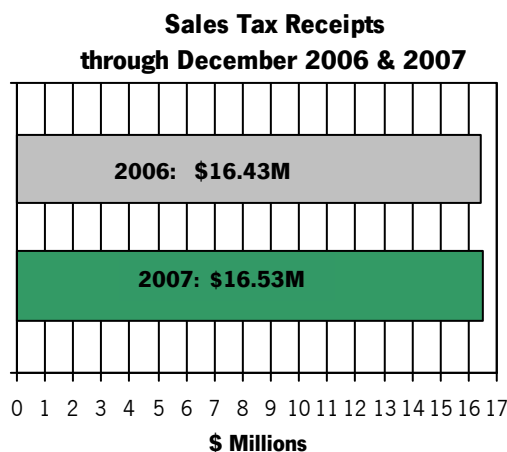


A Kirkland family was the fortunate recipient of an "Extreme Home Makeover" from the ABC television show, which aired in December. City staff from several departments coordinated the permit and inspection processes to make sure the show's deadlines were met. Many employees and citizens also donated their own time to work on the actual construction.

Sales Tax Revenue Analysis Sales tax revenue posted negative results for the last five months of 2007 compared to 2006. As a result, the year ended **up 0.6 percent** over 2006 primarily due to significant softening in contracting revenue (see table on page 6).

Review by business sectors:

- The **miscellaneous** sector is **up 39.7 percent** due to a significant one-time receipt.
- **Auto/gas retail** remains the strongest "ongoing" performer for the year, **up 10.2 percent** compared to 2006 due to increased revenue from several key retailers, as well as two new smaller retailers. However, the last two months of December show a softening trend in this important business sector.
- **General merchandise/miscellaneous retail** is **up 1.5 percent** over 2006 due to flat performance by key retailers.
- **Retail eating/drinking** is **up 5.4 percent** compared to 2006 due to relatively good results from several larger businesses as well as the collection of a past-due account from prior years.
- **Other retail declined 3.5 percent** over 2006 due to closure of two major retailers and one-time anomalies in the retail food and health care sectors in 2006 that skew comparisons between the years.
- All business sectors but one impacted by development-related activity (contracting, wholesale, services and communications) are posting negative results in 2007 compared to 2006. Comparing to 2006: the **services** sector is **up 3.3 percent** reflecting continued strong performance in this sector from development as well as a new hotel; **contracting** is **down 8.3 percent**, and the **communications** sector is **down 17.1 percent** due to a decline in development-related activity compared to 2006; and **wholesale** is **down 15.8 percent**, as a result of declining development activity compared to 2006.



Although slowing the last two months of the year, auto/gas retail growth helped balance declines in development revenue in 2007.

Development-related sales tax revenue is falling behind 2006, but remains strong compared to historical trends (up 69 percent over 2004 revenue).

Bellevue ended the year with strong sales tax performance (up 16.5 percent) primarily due to the high level of development-related activity in 2007. Redmond was up 25.5 percent almost entirely due to one-time field recoveries; otherwise Redmond would be up about 3.2 percent.

City of Kirkland Total Actual Year-to-date Sales Tax Receipts

Business Sector Group	Jan - Dec		Dollar Change	Percent Change	Percent of Total	
	2006	2007			2006	2007
Services	1,722,501	1,779,742	57,241	3.3%	10.5%	10.8%
Contracting	3,279,243	3,007,168	-272,075	-8.3%	20.0%	18.2%
Communications	793,243	657,923	-135,320	-17.1%	4.8%	4.0%
Auto/Gas Retail	2,973,380	3,276,488	303,108	10.2%	18.1%	19.8%
Gen Merch/Misc Retail	2,524,268	2,562,537	38,269	1.5%	15.4%	15.5%
Retail Eating/Drinking	1,228,127	1,294,444	66,317	5.4%	7.5%	7.8%
Other Retail	1,800,744	1,738,458	-62,286	-3.5%	11.0%	10.5%
Wholesale	1,320,124	1,111,079	-209,045	-15.8%	8.0%	6.7%
Miscellaneous	786,514	1,098,629	312,115	39.7%	4.7%	6.7%
Total	16,428,144	16,526,468	98,324	0.6%	100.0%	100.0%

Kirkland's sales tax base is comprised of a variety of businesses which are grouped and analyzed by business sector (according to NAICS, or "North American Industry Classification System"). Nine business sector groupings are used to compare 2006 and 2007 year-to-date sales tax receipts in the table to the left.

Month	Sales Tax Receipts		Dollar Change	Percent Change
	2006	2007		
January	1,116,572	1,267,021	150,449	13.5%
February	1,821,021	1,525,665	(295,356)	-16.2%
March	1,126,328	1,154,890	28,562	2.5%
April	1,061,134	1,604,395	543,261	51.2%
May	1,309,595	1,496,755	187,160	14.3%
June	1,311,259	1,422,662	111,403	8.5%
July	1,285,154	1,428,250	143,096	11.1%
August	1,749,896	1,253,921	(495,975)	-28.3%
September	1,457,353	1,445,966	(11,387)	-0.8%
October	1,400,232	1,299,258	(100,974)	-7.2%
November	1,478,235	1,348,896	(129,339)	-8.7%
December	1,311,365	1,278,789	(32,576)	-2.5%
Total	16,428,144	16,526,468	98,324	0.6%

When analyzing monthly sales tax receipts, there are two items of special note: First, most businesses remit their sales tax collections to the Washington State Department of Revenue on a monthly basis. Small businesses only have to remit their sales tax collections either quarterly or annually, which can create anomalies when comparing the same month between two years. Second, for those businesses which remit sales tax monthly, there is a two month lag from the time that sales tax is collected to the time it is distributed to the City. For example, sales tax received by the City in December 2007 is for sales actually made in October 2007. Monthly sales tax receipts through December 2006 and 2007 are compared in the table to the left.

One-time spikes (in development-related revenue in February and August 2006 and the miscellaneous category and development-related revenue in April 2007) skew monthly comparisons between the years. August was also impacted by a significant correction by the Department of Revenue to contracting revenue that had been received in April 2007. The last 5 months of 2007 experienced negative trends compared to 2006.

Kirkland's sales tax base is further broken down by business district (according to geographic area), as well as "unassigned or no district" for small businesses and businesses with no physical presence in Kirkland.

Totem Lake, which accounts for over 30 percent of the total sales tax receipts, is **up 7.1 percent** over 2006 primarily due to strong performance in auto/gas retail, a new hotel and sporting goods store, and despite the closure of a major super-market and electronics store. Al-

most 60 percent of this business district's revenue comes from the auto/gas retail and general merchandise/miscellaneous retail sectors.

NE 85th Street, which accounts for over 14 percent of the total sales tax receipts, is **up 3.4 percent** over 2006 primarily due to the automotive/gas retail, general merchandise/miscellaneous retail and retail eating/drinking sectors. Over 86 percent of this business district's revenue comes from these three business sectors.

Downtown, which accounts for over 6 percent of the total sales tax receipts, is **up 1.7 percent** over 2006 primarily due to moderately

strong performance in the retail eating/drinking sector, which provides over 42 percent of this business district's revenue and despite declines in other retail and miscellaneous sector (manufacturing).

Carillon Point & Yarrow Bay, which accounts for 3 percent of the total sales tax receipts, is **down 0.6 percent** from 2006 primarily due to weak performance in communications and retail eating/drinking and despite strong performance in the business services and hotel sectors. Almost 80 percent of this business district's revenue comes from business services, retail eating/drinking and hotels.

Houghton & Bridle Trails, which accounts for almost 4 percent of the total sales tax receipts, is **up 17.8 percent** over 2006 almost entirely due to miscellaneous retail, which provides 36 percent of these business districts' revenue.

Juanita, which accounts for almost 2 percent of the total sales tax receipts, is **up 7.1 percent** over 2006 primarily due to the retail eating/drinking sector, which provides almost 44 percent of this business district's revenue.

When reviewing sales tax receipts by business district, it's important to point out that 41 percent of the revenue received in 2007 is in the "unassigned or no district" category largely due to contracting revenue (which has declined compared to last year), and increasing revenue from Internet, catalog sales and other businesses located outside of the City.

City of Kirkland Sales Tax by Business District

Business District	Jan - Dec Receipts		Dollar Change	Percent Change	Percent of Total	
	2006	2007			2006	2007
Totem Lake	4,753,780	5,091,625	337,845	7.1%	28.9%	30.8%
NE 85th St	2,361,132	2,441,384	80,252	3.4%	14.4%	14.8%
Downtown	1,071,865	1,090,444	18,579	1.7%	6.5%	6.6%
Carillon Pt & Yarrow Bay	494,436	491,422	-3,014	-0.6%	3.0%	3.0%
Houghton & Bridle Trails	532,766	627,827	95,061	17.8%	3.2%	3.8%
Juanita	264,154	282,786	18,632	7.1%	1.6%	1.7%
Unassigned or No District:						
Contracting	3,279,273	3,004,347	-274,926	-8.4%	20.0%	18.2%
Other	3,670,738	3,496,633	-174,105	-4.7%	24.0%	22.8%
Total	16,428,144	16,526,468	98,324	0.6%	100.0%	100.0%

Sales Tax Revenue Outlook The double-digit sales tax revenue increases experienced over the previous two years disappeared in 2007 largely due to the decline in development-related activity. However, a large percentage of sales tax revenue continues to come from this one-time activity, which cannot be relied upon to fund ongoing services. The vulnerability of dependence on sales tax revenue became increasingly evident as 2007 ended. While down from 2006, development related activity remained high in 2007 compared to historical averages and may not be sustainable over the long term. In addition to concerns about a general economic downturn, Costco has confirmed their plans to open new stores in Redmond and Bellevue by the end of 2008. By their estimates, the Kirkland store will lose about one third of its sales from the opening of the new stores. This impact would be felt starting in early 2009 and would compound the negative effect from other factors, which may include the relocation of the sales portion of a major automobile dealership as well as a general economic downturn.

Developing ongoing business activity is critical to ensure the City's financial health. Opportunities for growth in ongoing revenue exist from the redevelopment of Totem Lake Mall and Park Place, the completed expansions of major car dealerships, and the two additional hotels. These risks and opportunities serve as reminders that sales tax is an economically sensitive revenue source. In good times, sales tax growth easily outpaces the rate of inflation and is an attractive funding source for service packages. On the other hand, an economic recession and the return of more normal development-related activity can quickly threaten the City's financial ability to maintain existing services (as it did in 2002).

OFFICE VACANCIES:

The Eastside vacancy rate remains low at 9.3 percent and Kirkland's rate is 4.7 percent as of the fourth quarter of 2007 according to CB Richard Ellis Real Estate Services.

LODGING TAX REVENUE:

Lodging tax revenue in 2007 is up 32.8 percent compared to 2006 due to overall strong performance in the accommodations industry as well as the new hotel in Totem Lake. An additional hotel opened downtown in late 2007. The full impact won't happen until 2008.

Economic Environment Update There are conflicting forces at work impacting the local economy. On one hand, local job growth remained strong in 2007 with more than 136,000 jobs added in the Seattle-Tacoma metropolitan area since January 2005. The unemployment rate in King County dropped to 3.6 percent as of December 2007, well below the national and Washington State average of 4.8 percent. Global conditions create a positive affect; decent global growth rates and the declining dollar supports growth in exports, adding 0.5 percent to the Puget Sound's growth rate. Taxable retail sales in King County remained strong, up 9.7 percent for 2007 compared to 2006 largely due to strong development activity in Bellevue, Seattle and unincorporated King County. As of the fourth quarter of 2007, the Puget Sound office market saw its 18th quarter of positive absorption. Over 1.9 million square feet of space was filled in 2007 and 20 million square feet is in the planning stages. The Puget Sound region office market is expected to remain one of the strongest in the nation for some time.

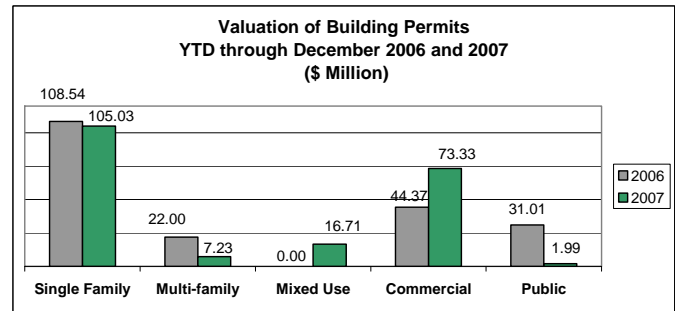
On the other hand, slumping housing sales, volatility in the credit markets, and general concern in consumer and business confidence on a national and local level could easily dampen economic growth locally. The rest of the nation is this region's largest market for goods. If there is a significant national recession, it would affect this area. If the national economy starts to expand by the end of 2008, Washington's economy may be able to weather the national recession without too much negative impact. A longer or deeper recession would most likely be felt in this region.

As mentioned in the sales tax analysis, significant risks from business changes and slowing development activity could pose a challenge for the near future.

Local **development activity** comparing 2007 to 2006 as measured by the valuation of City of Kirkland building permits is illustrated in the chart to the right. Activity remains relatively strong, especially in the commercial /mixed use sectors. Single family activity in 2007 trended below 2006 levels for most of the year, but improved by the end of the year. The significant spike in 2006 public activity reflects the permitting for Evergreen Hospital. Concerns about the slowing local real estate market could have a significant impact on residential development activity in 2008.

Pending sales of **new and existing single-family homes** in King County are down 34 percent in December 2007 compared with a year earlier and prices declined 1.1 percent for closed sales compared to the same month last year. The median price of a single family home in December was \$435,000—down from \$445,000 in December 2006. On the Eastside, closed sales are down 36.6 percent and the median price is up 1.6 percent to \$589,500. Contributing factors to the slow-down in sales are housing prices overshooting wages, economic uncertainty and tightening consumer credit. Local economists predict 2008 housing prices to flatten to zero or decline as part of market correction and the demand for housing will keep the correction time short. However, this is contingent on the local economy remaining strong and order being restored to credit markets.

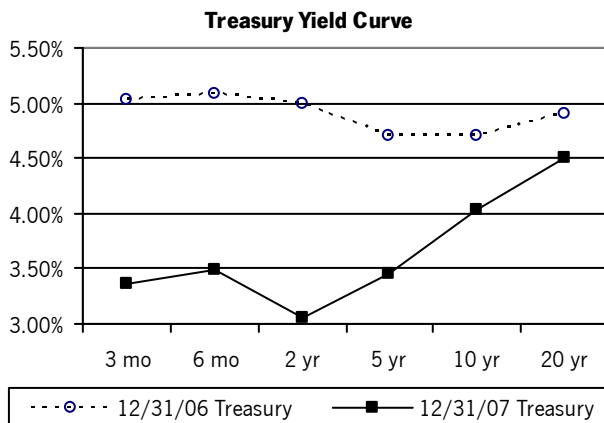
Seattle metro CPI continues to track higher than the national average (4.8 percent compared to the national average of 4.3 percent as of December). This is an increase from the Seattle index for June, which was 3.31 percent. The June 2007 CPI is used to calculate City employee cost of living adjustments (COLA) for 2008. As a result, 2008 COLA's will range from 2.98 to 3.31 percent depending on the bargaining unit contract.



Investment Report

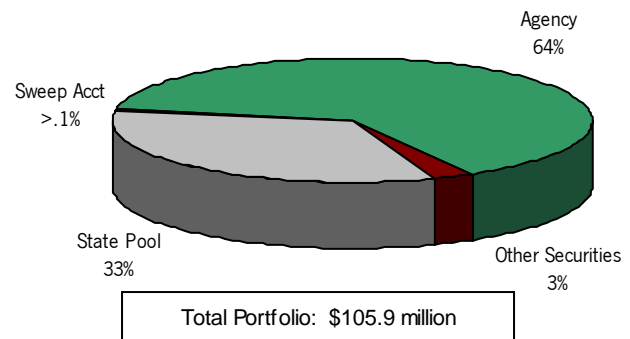
MARKET OVERVIEW

With economic news negative and problems in the subprime mortgage market the yield curve dropped and steepened as short term rates fell further than long term rates. The Fed Funds rate ended the year at 4.25%, down from 5.25% on December 31, 2006. The Fed Funds rate continued to decline in January 2008 to 3.00%. It is anticipated that the Fed Funds rate will continue to drop to 2.00% by the end of 2008.



The primary objectives for the City of Kirkland's investment activities are: legality, safety, liquidity and yield. Additionally, the City diversifies its investments according to established maximum allowable exposure limits so that reliance on any one issuer will not place an undue financial burden on the City. The City's portfolio increased nearly \$8 million in 2007 due to increases in utility funds and reserves. On December 31, 2007 Kirkland's portfolio balance was \$105.9 million compared to \$97.9 million on December 31, 2006.

Investments by Category



CITY PORTFOLIO

It is the policy of the City of Kirkland to invest public funds in a manner which provides the highest investment return with maximum security while meeting the City's daily cash flow requirements and conforming to all Washington state statutes governing the investment of public funds.

Diversification

The City's current investment portfolio is composed of Government Agency bonds, State and Local Government bonds, US Treasury notes, the State Investment Pool and an overnight bank sweep account. City investment procedures allow for 100% of the portfolio to be invested in US Treasury or Federal Government obligations.

2008 ECONOMIC OUTLOOK and INVESTMENT STRATEGY

The outlook for 2008 continues to change rapidly with the weak economic growth and the severity of the housing downturn. GDP growth for 2008 is now expected to be 1.3% and core inflation to range between 2% and 2.2%. Beyond the very short term, the forecasters see little threat of accelerating inflation. The unemployment rate is expected to average 5.1% in 2008, up from earlier expectations of 4.7% in 2008. The Fed Funds rate, currently at 3.00% as of January 30, 2008, is expected to be further reduced at the March 18, 2008 meeting to 2.50% and possibly reduced to 2.00% by the end of 2008.

The duration of the portfolio will be shortened as securities mature and are called. Purchases will be made as opportunities for increased returns become available. During period of low interest rates the portfolio duration should be kept shorter with greater liquidity to take advantage of purchasing securities with higher returns when interest rates begin to rise. The State Pool is currently near 3.25 % and will continue to decline as the Fed Funds rate declines. Total estimated investment income for 2008 is \$4.2 million compared to \$3.7 million budgeted.

Investment Report *continued*

Liquidity

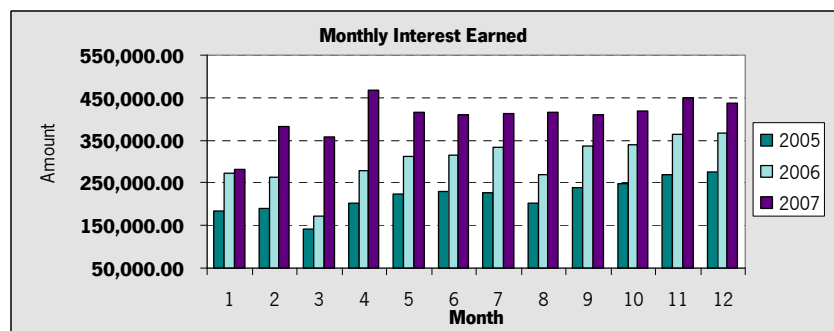
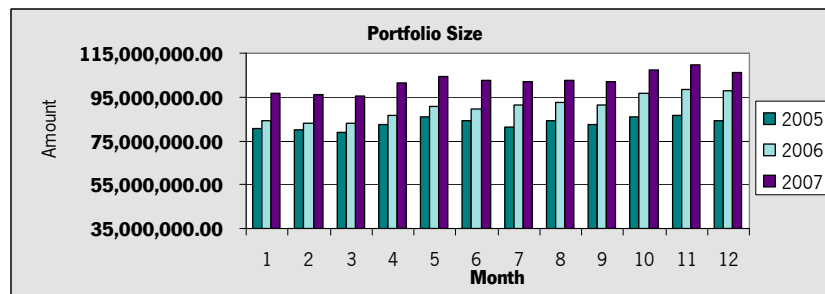
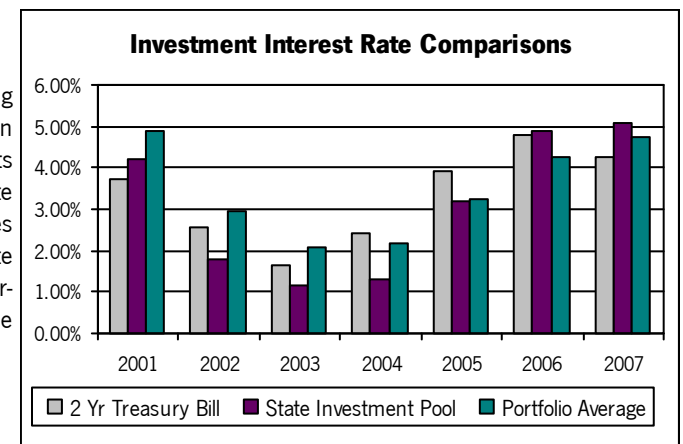
During 2007, the average maturity of the City's investment portfolio increased from .99 years to 2.01 years. This is above the target duration of 1.2 years as securities with longer maturities were purchased in the 4th quarter of 2007 to sustain higher earnings as interest rates began to rapidly decline. The target duration is based on the 2 year treasury rate which decreased from 4.82% on December 31, 2006 to 3.05% on December 31, 2007.

Yield

The City Portfolio yield to maturity increased from 4.51% on December 31, 2006 to 4.89% on December 31, 2007. Through December 31, 2007, the City's annual average yield to maturity was 4.75%, which performed under the State Investment Pool annual average yield to maturity at 5.09% and above the 2 Year Treasury note annual average for 2007 at 4.27%.

The City's practice of investing further out on the yield curve than the State Investment Pool results in earnings higher than the State Pool during declining interest rates and lower earnings than the State Pool during periods of rising interest rates. This can be seen in the adjacent graph.

Benchmark Comparison	December 31, 2006	December 31, 2007
City Yield to Maturity (YTM)	4.51%	4.89%
City Annual Average YTM	4.25%	4.75%
City Year to Date Cash Yield	3.99 %	4.73%
State Pool Average Yield	4.90%	5.09%
2 yr Treasury Note Avg YTM	4.71%	4.27%



Reserve Summary

General Operating Reserve

For the City's "Rainy Day" fund, the target is established by fiscal policy at five percent of the operating budget (excluding utility and internal service funds). Each year, the target amount will change proportional to the change in the operating budget. To maintain full funding, the increment between five percent of the previous year's budget and the current budget would be added or subtracted utilizing interest income and year-end transfers from the General Fund. It is a reserve to be used for unforeseen revenue losses and other temporary events. If the reserve is utilized by the City Council, the authorization should be accompanied by a plan for replenishing the reserve within a two to three year period.

Revenue Stabilization Reserve

The Revenue Stabilization Reserve was approved by Council in July 2003 and was created by segregating a portion of the General Operating Reserve. The purpose of this reserve is to provide an easy mechanism to tap reserves to address temporary revenue shortfalls resulting from temporary circumstances (e.g. economic cycles, weather-related fluctuations in revenue). Council set the target at ten percent of selected General Fund revenue sources which are subject to volatility (e.g. sales tax, development fees and utility taxes). The Revenue Stabilization Reserve may be used in its entirety; however, replenishing the reserve will constitute the first priority for use of year-end transfers from the General Fund.

Contingency Fund

The Contingency Fund was established pursuant to RCW 35A.33.145 to "provide monies with which to meet any municipal expense, the necessity or extent of which could not have been foreseen or reasonably evaluated at the time of adopting the annual budget." State law sets the maximum balance in the fund at \$.375 per \$1,000 of assessed valuation. This reserve would be used to address unforeseen expenditures (as opposed to revenue shortfalls addressed by the Revenue Stabilization Reserve). The fund can be replenished through interest earnings up to the maximum balance or through the year-end transfer if needed.

Reserves are an important indicator of the City's fiscal health. They effectively represent "savings accounts" that are established to meet unforeseen budgetary needs (general purpose reserves) or are otherwise dedicated to a specific purpose (special purpose reserves). The City's reserves are listed with their revised estimated balances at the end of the biennium in the table below:

Reserves	2007-08 Est End Balance	2007 Auth. Uses	2007 Auth. Additions	Revised 2007-08 End Balance
GENERAL PURPOSE RESERVES				
Contingency	3,193,826	365,936		2,827,890
General Capital Contingency	3,312,834			3,312,834
Park & Municipal Reserve:				
General Oper. Reserve (Rainy Day)	2,712,836			2,712,836
Revenue Stabilization Reserve	2,082,380			2,082,380
Building & Property Reserve	1,921,002	10,000		1,911,002
Council Special Projects Reserve	309,960	33,000		276,960
Total General Purpose Reserves	13,532,838	408,936	0	13,123,902
SPECIAL PURPOSE RESERVES				
Excise Tax Capital Improvement:				
REET 1	6,673,678	796,394		5,877,284
REET 2	6,067,898			6,067,898
Equipment Rental:				
Vehicle Reserve	5,907,138			5,907,138
Radio Reserve	36,000			36,000
Information Technology:				
PC Replacement Reserve	453,670			453,670
Major Systems Replacement Reserve	666,500			666,500
Facilities Maintenance:				
Operating Reserve	550,000			550,000
Facilities Sinking Fund	1,439,951			1,439,951
Impact Fees				
Roads	1,984,145			1,984,145
Parks	920,086			920,086
Park Bond Reserve	502,916			502,916
Cemetery Improvement	476,401			476,401
Off-Street Parking	29,564			29,564
Tour Dock	73,211			73,211
Street Improvement	1,121,498	161,100		960,398
Firefighter's Pension	1,359,860			1,359,860
Park & Municipal Reserve:				
Litigation Reserve	20,004			20,004
Labor Relations Reserve	51,255			51,255
Police Equipment Reserve	26,519			26,519
LEOFF 1 Police Reserve	625,754			625,754
Facilities Expansion Reserve	800,000			800,000
Development Services Reserve	1,290,831			1,290,831
Tree Ordinance	13,750			13,750
Donation Accounts	143,859			143,859
Revolving Accounts	148,606			148,606
Water/Sewer Operating Reserve	1,511,245			1,511,245
Water/Sewer Debt Service Reserve	820,155			820,155
Water/Sewer Capital Contingency	1,703,640	500,200		1,203,440
Water/Sewer Construction Reserve	8,738,358	835,000		7,903,358
Surface Water Operating Reserve	320,299			320,299
Surface Water Capital Contingency	876,760	202,000		674,760
Surface Water-Transp. Related Rsv	1,417,365	236,000		1,181,365
Surface Water Construction Reserve	1,240,563			1,240,563
Total Special Purpose Reserves	48,011,479	2,730,694	0	45,280,785
Grand Total	61,544,317	3,139,630	0	58,404,687

Reserve Summary *continued*

RESERVE	AMOUNT	DESCRIPTION
2007 Council Authorized Uses	\$3,139,630	
Contingency Fund	\$31,500	Funding for phase 1 of the Permit Process Improvement Project to review the single family building permit process.
	\$54,436	Funding for continued public outreach for Phase II of the annexation study.
	\$280,000	Funding for a Planned Action Environmental Impact Statement and fiscal review related to the Park Place re-development.
Building/Property Reserve	\$10,000	Funding for a study of the Peter Kirk restroom to coincide with the timing of the design for the downtown transit center.
Council Special Projects Reserve	\$15,000	Funding for the Assistance League of the Eastside's Operation School Bell program.
	\$18,000	Funding for assistance with affordable housing regulations work plan.
Real Estate Excise Tax (REET) 1 Reserve	\$235,840	Funding for the purchase of the Irvin Property in the Yarrow Bay Wetlands.
	\$362,354	Funding for the purchase of greenbelt property near Everest Park.
	\$193,200	Funding for purchase of the Niedermeier property near Everest Park.
	\$5,000	Funding for the purchase appraisal and closing costs related to the Shelton property.
Street Improvement Reserve	\$91,100	Additional funding for completion of the Central Way Improvements project (street portion).
	\$70,000	Additional funding for the 2007 Pavement Striping Program.
Water/Sewer Capital Contingency	\$113,900	Additional funding for completion of the Central Way Improvements project (utilities portion).
	\$250,000	Additional funding for water system improvements projects.
	\$81,000	Additional funding for Waverly Beach Lift Station project.
	\$55,300	Additional funding for 7th Avenue/114th Avenue NE Watermain Replacement.
Water/Sewer Construction Reserve	\$835,000	Additional funding to complete the 2007 Emergency Sewer Program.
Surface Water Capital Contingency	\$202,000	Additional funding for the Juanita Creek Channel Enhancement project.
Surface Water Transportation Reserve	\$236,000	Additional funding for the 116th Ave NE (north) Non-motorized facilities (surface water portion).
2007 Council Authorized Additions	\$0	

No Council Authorized Additions as of December 31, 2007.

Reserves	Revised 2007-08 End Balance	2007-08 Target	Over (Under) Target
GENERAL PURPOSE RESERVES			
Contingency	2,827,890	3,698,455	(870,565)
General Capital Contingency	3,312,834	5,822,280	(2,509,446)
Park & Municipal Reserve:			
General Oper. Reserve (Rainy Day)	2,712,836	3,134,779	(421,943)
Revenue Stabilization Reserve	2,082,380	2,143,422	(61,042)
Council Special Projects Reserve	276,960	250,000	26,960
General Purpose Reserves with Targets	11,212,900	15,048,936	(3,836,036)
SPECIAL PURPOSE RESERVES			
Excise Tax Capital Improvement:			
REET 1	5,877,284	1,435,000	4,442,284
REET 2	6,067,898	4,959,200	1,108,698
Information Technology:			
Major Systems Replacement Reserve	666,500	1,025,000	(358,500)
Firefighter's Pension	1,359,860	1,103,000	256,860
Park & Municipal Reserve:			
Litigation Reserve	20,004	50,000	(29,996)
LEOFF 1 Police Reserve	625,754	855,000	(229,246)
Development Services Reserve	1,290,831	1,290,831	0
Water/Sewer Operating Reserve	1,511,245	1,511,245	0
Water/Sewer Debt Service Reserve	820,155	820,155	0
Water/Sewer Capital Contingency	1,203,440	1,703,640	(500,200)
Surface Water Operating Reserve	320,299	320,299	0
Surface Water Capital Contingency	674,760	876,760	(202,000)
Special Purpose Reserves with Targets	20,438,030	15,950,130	4,487,900
Reserves without Targets	26,753,757	n/a	n/a
Total Reserves	58,404,687	n/a	n/a

The summary in the section above details all Council authorized uses and additions to each reserve through December 2007.

The table to the left compares the revised ending balance to the targets established in the budget process .



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- ◆ Sri Krishnan, Senior Financial Analyst
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www.ci.kirkland.wa.us

The **Financial Management Report (FMR)** is a high-level status report on the City's financial condition that is produced quarterly.

- It provides a summary **budget to actual** comparison for year-to-date revenues and expenditures for all operating funds. The report also compares this year's actual revenue and expenditure performance to the prior year.
- The **Sales Tax Revenue Analysis Report** takes a closer look at the City's largest and most economically sensitive revenue source.
- **Economic environment** information provides a brief outlook at the key economic indicators for the Eastside and Kirkland such as office vacancies, residential housing prices/sales, development activity, inflation and unemployment.
- The **Investment Summary** report includes a brief market overview, a snapshot of the City's investment portfolio, and the City's year-to-date investment performance.
- The **Reserve Summary** report highlights the uses of and additions to the City's reserves in the current year as well as the projected ending reserve balance relative to each reserve's target amount.

Economic Environment Update References:

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- U.S. Bureau of Labor Statistics
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